

# Executive Summary

General Fund receipts totaled \$2,188.6 million for the second quarter of fiscal year 2006 (FY06), increasing from FY05 by 11.5 percent. This represents \$226.4 million more than reported in the same period one year earlier. The Road Fund rose by 3.0 percent during the second quarter, and economic growth as measured by Kentucky personal income, was up by 5.1 percent.

Performance in the General Fund categories for the second quarter were affected not only by economic conditions but also by changes enacted in HB 272 (*JOBS for Kentucky*). Sales and use tax revenues were up by 6.3 percent. Individual income tax receipts rose by 1.2 percent, reflecting tax cuts enacted that began to take effect in July. Corporation income and license taxes posted sharp growth of 99.4 percent reflecting both the strength of the economy and the shift in revenues away from individual income taxes and into the corporation income tax for pass-through entities.

Coal severance taxes rose by 20.4 percent continuing their strong recent performance. Cigarette taxes, boosted by an increase in the rate, were up by 1,048.7 percent in the second quarter of FY06. Property taxes were 7.3 percent higher than a year earlier, affected

by timing differences in collection of some accounts.

During the second quarter of FY06, lottery revenues fell by 4.3 percent compared to the second quarter of FY05. Receipts a year earlier were extraordinarily high due to large sales of Powerball tickets earlier in the summer. Such sales did not re-occur in the same period of 2006. All other receipts combined for a decline of 2.4 percent.

Road Fund receipts were boosted by a recalculation of the statutory rate of motor fuels taxes, which are tied to the wholesale price of motor fuels. For the second quarter, the Road Fund grew by 3.0 percent. Motor fuels taxes rose by 11.2 percent, while motor vehicle usage tax receipts fell by 11.7 percent as the termination of automotive

manufacturer discounts kept potential customers away from showrooms.

Weight distance tax revenues rose by 2.1 percent, and motor vehicle license tax revenues grew by 14.5 percent. Motor vehicle operators license tax rose by 151.1 percent due to an increase in drivers' license fees charged by the state.

The U.S. economy as measured by real gross domestic product (GDP) was estimated to have expanded by 3.0 percent in the second quarter of FY06.<sup>1</sup> Personal income also rose



<sup>1</sup> GDP is presented in this report as estimated by Global Insight in November 2005. Actual GDP advance estimates for the quarter may have been released prior to printing this report, and may vary from the Global Insight estimate.

by a healthy 7.8 percent. Kentucky's economy as measured by personal income grew by 5.1 percent over the same period one year earlier. Employment in the state grew by 1.2 percent as 20,900 jobs were added to the payroll during the second quarter.

The interim forecast for the General Fund expects revenues to rise by 3.4 percent over the final two quarters of FY06. Total revenues for the entire fiscal year are forecasted to reach \$8,208.3 million, which is \$7.9 million less than the official estimate approved by the Consensus Forecasting Group on December 20, 2005. Changes in tax laws brought about in *JOBS for Kentucky* will affect revenues over the remainder of the fiscal year.

Among the major accounts, the outlook for the next two quarters of FY06 is for sales and use tax revenues to rise by 1.9 percent, the individual income tax to decline by 9.0 percent, corporation income and license taxes to grow by 33.8 percent, and coal severance tax receipts to expand by 5.0 percent.

The cigarette tax was most affected by an increase in the rate from three cents per pack to 30 cents, and revenues are estimated to grow by 225.4 percent in the last six months of FY06. Property tax receipts will fall by 5.7 percent, and dividend payments from the lottery should rise by 24.8

percent. "Other" taxes and revenues will combine for an increase of 17.0 percent during the final two quarters due primarily to new taxes created in *JOBS for Kentucky* on telecommunications services and other tobacco products. For the first quarter of FY07, General Fund receipts are forecasted to rise by 3.9 percent.

The interim outlook for the Road Fund anticipates an increase in revenues of 2.9 percent for the last two quarters of FY06. This is unchanged from the official consensus revenue estimate of December 20. Motor fuels taxes will grow by 6.0 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to decline by 1.7 percent, and motor vehicle operators' license fees are projected to expand by 237.9 percent because of an increase in the fee effective this fiscal year. For the first quarter of FY07, the Road Fund should grow by only 0.6 percent.

The outlook for the national economy foresees real GDP growth of 3.5 percent over the remainder of FY06, and personal income growth of 6.1 percent. In Kentucky, personal income is expected to rise by 5.6 percent, while employment should rise by 1.4 percent or 24,700 jobs. In the first quarter of FY07, Kentucky personal income should continue to grow by a similar rate of 5.9 percent, and employment growth should continue at 1.4 percent.

# Revenue Receipts

## Second Quarter FY2006

### General Fund

The second quarter of FY06 experienced double-digit growth following a robust first quarter of this fiscal year. Second-quarter growth rates were boosted by increased receipts from the corporation income, cigarette, coal severance, and alcohol taxes. Receipts in the second quarter totaled \$2,188.6 million compared to \$1,962.2 million received in the second quarter of FY05. The resulting growth rate was 11.5 percent, and compares to a growth rate of 7.5 percent for the same quarter last year. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these and other accounts is available in the Appendix.

**Table 1**  
**Summary General Fund Receipts**  
**Second Quarter, FY06**  
**(mil \$)**

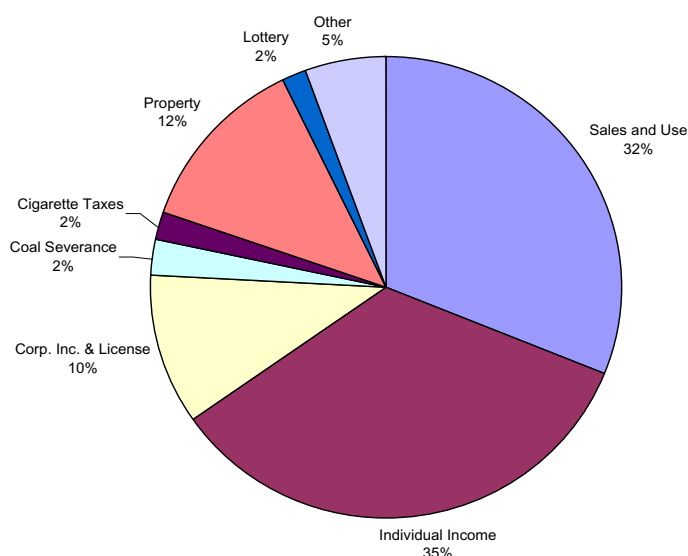
	<b>FY06</b>	<b>FY05</b>	<b>Diff (\$)</b>	<b>Diff (%)</b>
Sales and Use	683.0	642.8	40.2	6.3
Individual Income	747.6	739.1	8.5	1.2
Corp. Inc. & License	228.9	114.8	114.1	99.4
Coal Severance	53.1	44.1	9.0	20.4
Cigarette Taxes	44.8	3.9	40.9	1,048.7
Property	271.5	253.0	18.5	7.3
Lottery	40.0	41.8	-1.8	-4.3
Other	119.7	122.7	-3.0	-2.4
<b>TOTAL</b>	<b>2,188.6</b>	<b>1,962.2</b>	<b>226.4</b>	<b>11.5</b>

Variations in the quarterly receipts are often affected by differences in the timing of payments into revenue accounts. While timing differences were not as prevalent as in the past, property tax receipts continue to record fluctuations because of these differences.

**Total sales and use tax** receipts for the quarter were \$683.0 million, compared to \$642.8 million in the second quarter of FY05. The result is a growth rate of 6.3 percent and exceeds the 3.6 percent growth for the second quarter of last year.

**Individual income tax** posted receipts of \$747.6 million, compared to last year's second-quarter receipts of \$739.1 million. The resulting growth rate was 1.2 percent, and compares to a growth rate of 5.6 percent for the second quarter of last year. Slow growth in this revenue source is due to tax cuts and changes in law that now have certain limited-liability entities filing under the corporation income tax rather than under the individual income tax.

**Figure 1**  
**Second Quarter, FY06**  
**General Fund Receipts**



Combined **corporation income and license tax** receipts grew strongly in the second quarter of the fiscal year. Revenues of \$228.9 million were 99.4 percent higher than year-earlier figures of \$114.8 million. The rise in corporation income tax revenues is the mirror effect of the shift in reporting among limited liability entities.

**Coal severance tax** revenue continued to grow in the second quarter, with receipts up by 20.4 percent. Collections of \$53.1 million compare to the FY05 second quarter total of \$44.1 million.

**Cigarette tax** receipts of \$44.8 million in the second quarter of FY06 exceeded last year's total of \$3.9 million. The \$40.9 million increase was the result of tax increases enacted by the 2005 General Assembly.

Second-quarter **property tax** receipts posted revenues that were 7.3 percent higher than the second quarter of FY05. FY06 second-quarter receipts of \$271.5 million compare with \$253.0 million from the second quarter of FY05.

**Lottery** receipts were \$40.0 million which were 4.3 percent less than last year's second-quarter total of \$41.8 million.

The "**all other**" category, which represents the remaining accounts of the General Fund, fell 2.4 percent in the second quarter. Second quarter receipts for FY06 were \$119.7 million and compare to \$122.7 million in FY05.

## Road Fund

The Road Fund reported an increase of 3.0 percent in the second quarter of FY06. Receipts totaled \$264.3 million and com-

pare to \$256.7 million from the second quarter of last year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

**Motor fuels tax** receipts grew at a rate of 11.2 percent during the second quarter due to the formula-driven increase in the tax rate tied to the price of gasoline. Receipts were \$125.2 million and compare to \$112.6 million collected during the second quarter of last year.

**Motor vehicle usage tax** declined in the second quarter, with receipts down by 11.7 percent. Receipts during the second quarter of FY06 totaled \$81.4 million and compare to \$92.3 million collected during the same period last year.

**Motor vehicle license tax** receipts increased 14.5 percent in the second quarter of FY06 to \$16.6 million.

**Motor vehicle operators license tax** receipts were \$3.5 million in the second quarter of FY06. The 151.1 percent increase over FY05 second quarter receipts was a result of an increase in license fees.

**Weight distance tax** receipts of \$21.3 million represent a 2.1 percent increase

**Table 2**  
**Summary Road Fund Receipts**  
**Second Quarter, FY06**  
**(mil \$)**

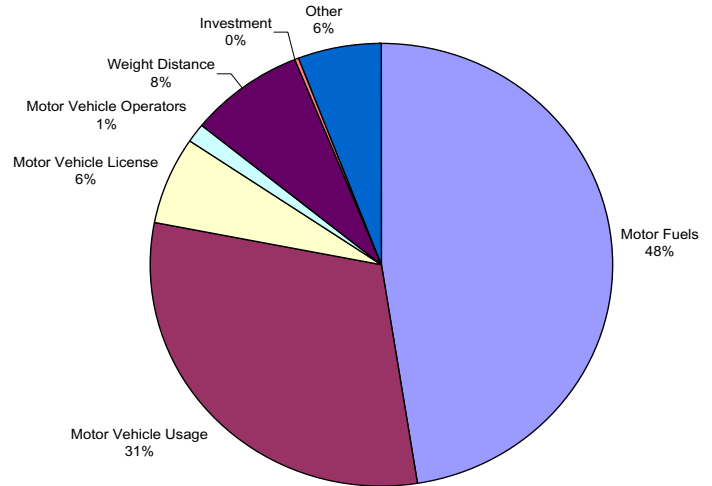
	<b>FY06</b>	<b>FY05</b>	<b>Diff (\$)</b>	<b>Diff (%)</b>
Motor Fuels & MF Use	125.2	112.6	12.6	11.2
Motor Vehicle Usage	81.4	92.3	-10.9	-11.7
Motor Vehicle License	16.6	14.5	2.1	14.5
Motor Veh Operators	3.5	1.4	2.1	151.1
Weight Distance	21.3	20.8	0.5	2.1
Investment Income	0.6	0.8	-0.2	-25.8
Other	<u>15.7</u>	<u>14.3</u>	<u>1.4</u>	<u>9.8</u>
<b>TOTAL</b>	<b>264.3</b>	<b>256.7</b>	<b>7.6</b>	<b>3.0</b>

over receipts of \$20.8 million during the second quarter of FY05.

**Investment receipts** of slightly over \$600,000 were 25.8 percent lower than the total collected in the second quarter of FY05.

The remainder of the accounts in the Road Fund combined for an increase of 9.8 percent from a year earlier. In the “all other” category, revenues of \$15.7 million compare to \$14.3 million in the second quarter of FY05.

**Figure 2**  
**Second Quarter, FY06**  
**Road Fund Receipts**



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# The Economy

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## NATIONAL ECONOMY Second Quarter, FY06

Real gross domestic product (GDP) is an inflation-adjusted measure of the total output of goods and services produced in the United States. Real GDP is estimated to have increased by 3.0 percent in the second quarter, following robust growth of 3.8 percent in the previous quarter<sup>1</sup>. The relatively high growth rate in the July-to-September quarter took most analysts by surprise since the increase in output occurred during two devastating hurricanes. This probably accounts for the slightly slower increase in output during the second quarter.

The strength of the domestic economy continues to be derived from the consumer. Consumption expenditures account for about two-thirds of real GDP. Real consumption was up a robust 2.7 percent in the second quarter following an increase of 3.8 percent in the first quarter. There was a marked slowdown in the consumption of durable goods, up just 0.4 percent, compared to a 6.6 percent increase in the previous quarter. The deceleration resulted from a decline in the consumption of motor vehicles and parts. The sharp gain in gasoline prices and the lack of automobile incentives during the October-to-December quarter caused auto consumption to contract by 7.6 percent compared to a 4.6 percent increase in the previous quarter. Consumption of nondu-

rable goods was up 5.0 percent. Nondurables are normally quite stable and not prone to swings from interest rates and incentives. Consumption was up 3.5 percent compared to 4.2 percent in the previous quarter. Services constitute a little over one-half of all consumption and about 35 percent of total GDP. The consumption of services increased by 2.8 percent in the second quarter. Most of the increase was in the areas of medical services, up 4.7 percent, and business services, up 4.1 percent.

Investment spending was up strongly as a result of both business confidence and low interest rates. The investment component of GDP increased by 6.2 percent during the second quarter after posting growth of 3.4 percent in the previous quarter. Equipment and software continued to be a strong drivers in this category with a growth of 9.2 percent, but were overshadowed by investment in mining and petroleum which was up 15.9 percent.

The Governor's Office for Economic Analysis (GOEA) monitors industrial production because it is a measure of the output of heavy industries like mining and manufacturing. These industries continue to play a vital role in Kentucky's economy. Industrial production is a raw measure of output, comprised of only the final products. The impact of hurricanes Katrina and Rita on the ports in New Orleans and the Gulf Coast caused total industrial production to decline by 0.8 percent during the second quarter after being up just 1.3 percent in the first quarter.

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<sup>1</sup> GDP is presented in this report as estimated by Global Insight in November 2005. Actual GDP advance estimates for the quarter may have been released prior to printing this report, and may vary from the Global Insight estimate.

Personal income, which is a measure of spending power, was \$10,487.7 billion in the second quarter, for an annualized increase of 7.8 percent over the previous quarter. The extraordinary gain in personal income was from both increased inflation and a surge in dividends, interest, and rent. Real disposable income was up 5.3 percent for the same quarter.

Inflation was up by 3.2 percent as a consequence of the sharp rise in energy prices. After excluding the relatively volatile energy and food, the core inflation was up just 2.4 percent. The unemployment rate stayed steady at 5.0 percent, the same as the previous quarter. Nonfarm employment posted a strong gain of 1.5 percent during the second quarter. Both construction and mining had large increases, though manufacturing declined.

## KENTUCKY ECONOMY

Kentucky was affected by low growth in employment as productivity pushed output without increasing the number of jobs. Current data indicates that although employment is still short of the historical peak of March 2000, there has been positive movement in the economy in response to the federal fiscal stimulus. Key measures like employment and income were firm in the second quarter.

Kentucky's personal income is estimated to be \$124.4 billion in the second quarter of FY06, an increase of 5.1 percent from a year ago. U.S. personal income grew by 4.6 percent during the same period. The relatively slower national growth was due to the impact of hurricanes Katrina and Rita on both employment and income. Wages and salaries constitute a little over half of personal income. Income derived from

wages and salaries is estimated to have grown by 5.0 percent in FY06:2.

Employment data is commonly used to gauge the strength of the state's economy, primarily because of its timely availability and its impact on consumer spending and confidence. Kentucky gained approximately 20,900 jobs during the second quarter compared to a year ago. This is a decided improvement in the state economy; a year ago the increase in employment was just 13,800.

Of the 1.8 million nonfarm jobs in Kentucky about one-fifth are in the goods-producing sectors: construction, mining, and manufacturing. Employment in the goods-producing sectors was up 5,000 for an increase of 1.4 percent during the second quarter. Low interest rates were directly responsible for the 4.2 percent increase in construction jobs. Mining employment in Kentucky is predominantly in the coal industry. The high price of natural gas—a direct substitute for coal—helped to boost coal prices and caused employment to increase by 4.1 percent. In contrast employment in manufacturing was up just 0.3 percent.

A little over sixty percent of Kentucky's nonagricultural jobs are in the service sector and other areas not related to the direct production of goods like finance; information; and trade, transportation, and utilities. The broad service-related industries are part of four newly categorized areas or super sectors. These are: business services, educational and health services, leisure and hospitality services, and other services. Overall employment in services was up 1.1 percent with the strongest gains in leisure and hospitality services (up 3.0 percent). Employment in government

accounts for 17 percent of all jobs in Kentucky and was up just 1.0 percent. Most of

the growth was in local government employment.

**Table 3**  
**Summary US Economic Conditions**  
**Second Quarter\***

			<b>SAAR**</b>
	<b>FY06:1</b>	<b>FY06:2</b>	<b>FY06:1 to FY06:2</b>
Real GDP (billion 2000 \$)	11,193.2	11,277.4	3.0
Personal Income (billion \$)	10,293.0	10,487.7	7.8
Real Disposable Income (billion 2000 \$)	8,110.5	8,216.6	5.3
Consumer Price Index (annual percent change)	5.1	3.2	-
Industrial Production (annual percent change)	1.3	-0.8	-
Civilian Labor Force (millions)	149.8	150.3	1.3
Nonfarm Employment (millions)	134.0	134.3	0.9
Manufacturing , Employment (millions)	14.3	14.2	-0.4
Unemployment Rate (percent)	5.0	5.0	-

Sources: Global Insight, Inc., and U.S. Dept. of Commerce, Bureau of Economic Analysis.

\* Data for FY06:2 are November 2005 estimates.

\*\* Seasonally adjusted annual percent growth rate.

**Table 4**  
**Selected Kentucky Economic Indicators**  
**Second Quarter, FY06**

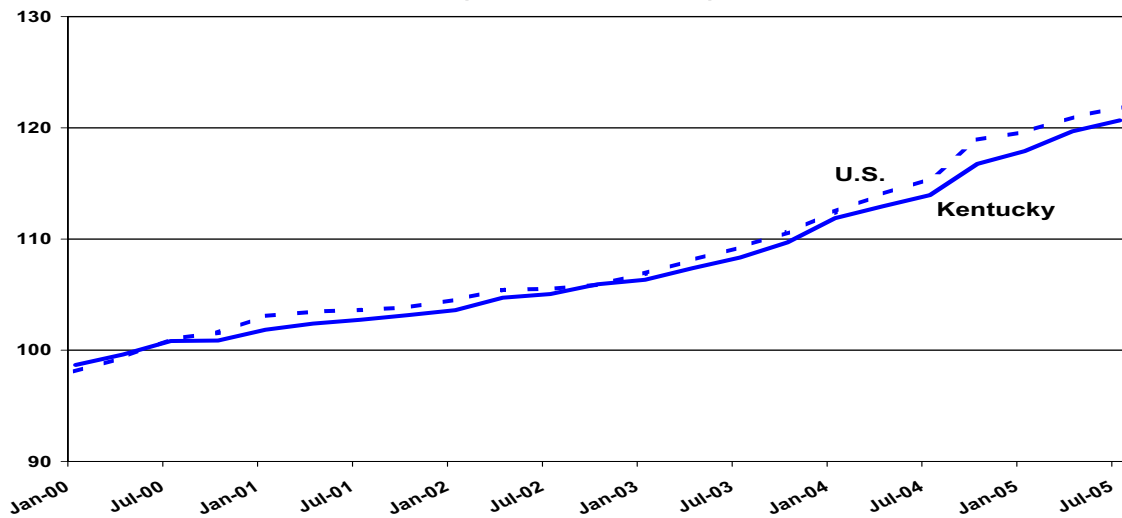
	<b>FY05:2</b>	<b>FY06:2</b>	<b>% Chg*</b>
Total Personal Income (\$ millions)	118,376	124,402	5.1
Wage & Salary Income (\$ millions)	63,053	66,224	5.0
Total Nonfarm Employment (000)	1,801.1	1,822.0	1.2
Contract Construction	84.1	87.6	4.2
Mining	19.7	20.5	4.1
Manufacturing	264.4	265.1	0.3
Trade, Transportation & Utilities	373.0	375.4	0.6
Information	28.2	28.5	1.0
Finance	86.1	86.2	0.1
Business Services	165.3	167.3	1.2
Educational & Health Services	231.8	235.7	1.7
Leisure and Hospitality Services	161.0	165.8	3.0
Other Services	78.9	78.2	-0.8
Government	308.5	311.6	1.0

\*Seasonally djusted rate from a year ago.

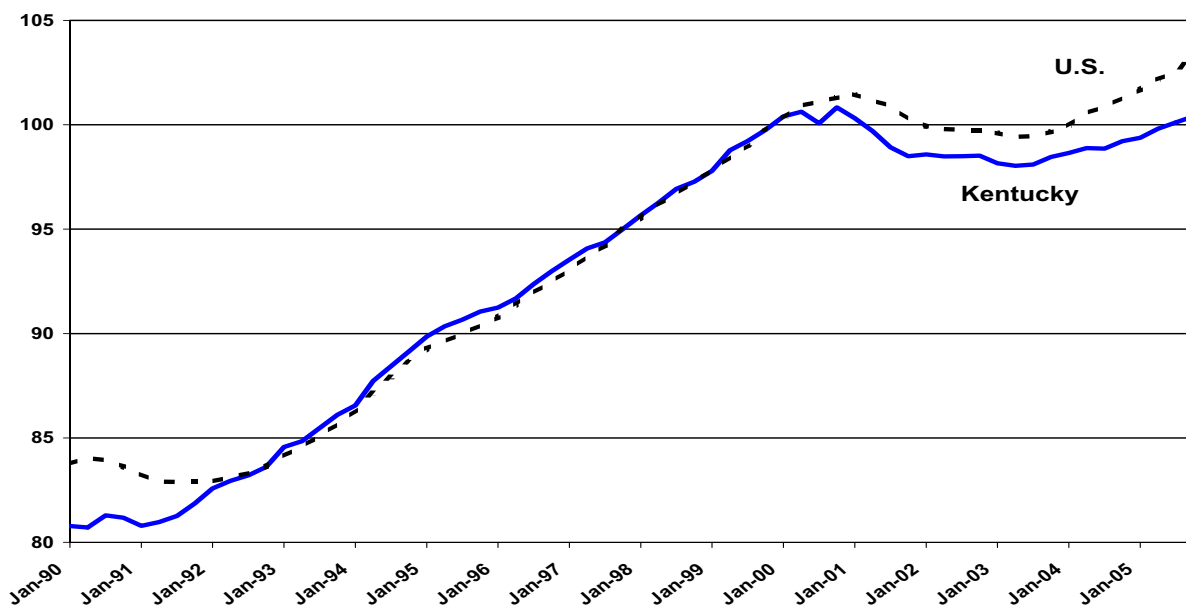
Note: Numbers may not add up due to rounding.

Sources: GOEA's Macromodel of Kentucky Forecast, November 2005

**Figure 3**  
**Personal Income: KY vs. U.S.**  
(Index FY00 = 100)



**Figure 4**  
**Nonfarm Employment Growth: KY vs. U.S.**  
(Index FY00 = 100)



# Interim Outlook

## GENERAL FUND

Projected General Fund revenues for the next three quarters are shown in Table 5. General Fund revenues were \$4,154.4 million in the first two quarters of FY06, a growth rate of 11.6 percent from the same period a year ago. Revenues grew strongly due to both improved economic performance and tax changes enacted by the 2005 General Assembly. Growth was strongest in the corporation income and license, cigarette, coal severance, and property taxes. Corporation income tax and cigarette tax receipts were affected by the changes in tax law while property collections were affected by timing issues.

Anticipated revenues for the last two quarters of FY06 are \$4,053.9 million, corresponding to a growth rate of 3.4 percent

from the previous fiscal year. Growth is expected to be positive in all major accounts except for the individual income tax, which was affected by the changes enacted by the 2005 General Assembly, and property taxes.

The official revenue estimate, including changes made by the 2005 General Assembly, anticipates General Fund revenues of \$8,216.2 million for FY06. The interim forecast as shown in Table 6 predicts that revenues will be \$8,208.3 million, a decrease of \$7.9 million from the official estimate. It is the opinion of GOEA that, given the uncertainties inherent in forecasting, the projected shortage does not represent a significant change in the General Fund outlook for FY06 when compared to the official estimate. As explained below, most major sources of revenue are expected to grow.

**Table 5**  
**General Fund: Interim Forecast**  
**(millions of dollars)**  
**January 2006**

	FY06		FY06		FY06		FY07	
	Quarters 1 & 2		Quarters 3 & 4		Full Year		Quarter 1	
	Actual	% Chg Year Ago	Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Estimate	% Chg Year Ago
Sales & Use	1,368.5	6.3	1,332.5	1.9	2,701.0	4.1	716.4	4.5
Individual Income	1,514.5	2.3	1,414.9	-9.0	2,929.4	-3.5	802.8	4.7
Corporation Income & Lic.	438.2	78.0	490.5	33.8	928.7	51.6	210.1	0.4
Coal Severance	105.4	21.2	102.3	5.0	207.7	12.6	52.3	0.0
Cigarette	98.2	1,140.4	83.8	225.4	182.0	440.5	42.2	-20.8
Property	325.0	11.4	170.7	-5.7	495.7	4.9	38.9	-27.2
Lottery	77.0	-11.2	93.0	24.8	170.0	5.4	41.4	11.8
Other	227.7	-3.6	366.1	17.0	593.8	8.1	138.8	28.4
<b>General Fund</b>	<b>4,154.4</b>	<b>11.6</b>	<b>4,053.9</b>	<b>3.4</b>	<b>8,208.3</b>	<b>7.4</b>	<b>2,042.8</b>	<b>3.9</b>

Total sales and use tax receipts for the first two quarters of FY06 were \$1,368.5 million, representing an increase of 6.3 percent from the same period a year ago. The projected rate of growth for the remaining two quarters of FY06 is 1.9 percent. Sales and use tax receipts for the first quarter of FY07 are forecast to grow 4.5 percent to \$716.4 million.

The interim forecast for the individual income tax calls for a drop of 9.0 percent for the remainder of FY06, amounting to collections of \$1,414.9 million in the final six months. The individual income tax rose by 2.3 percent in the first two quarters of FY06. For the entire fiscal year, individual income tax revenues are projected to decline by 3.5 percent. Collections in the first quarter of FY07 will be \$802.8 million, or 4.7 percent over collections in the previous year.

The outlook for corporation income and license taxes is for an increase of 33.8 percent in the final two quarters of FY06, representing collections of \$490.5 million. These anticipated collections will bring the FY06 total to \$928.7 million, an increase of 51.6 percent from FY05. Revenues in FY06 are affected by changes to both the corpora-

tion income and license tax. Corporation income tax revenues are expected to be boosted by inclusion of taxes paid by pass-through business entities, an alternative minimum calculation, and closing loop-holes. On the other hand, measures that will reduce revenues include a reduction in the top marginal corporation income tax rate from 8.25 percent to 7 percent, and the repeal of the corporation license tax.

The coal severance tax continued its recent robust growth in the first two quarters of the fiscal year, but the forecast is for growth to slow for the remainder of FY06. Growth is forecasted to be 5.0 percent for the remaining two quarters. Collections in this account will be flat in the first quarter of FY07 at \$52.3 million.

Cigarette taxes were increased by the 2005 General Assembly, which raised the rate on a pack from 3 cents to 30 cents. (Only 29 cents of the tax accrue to the General Fund). Additionally, a floor stocks tax was imposed on cigarette inventories. In the first two quarters, cigarette tax collections totaled \$98.2 million, including the floor stocks tax. The outlook for the remaining six months of the fiscal year is for \$83.8 million in revenue, with a corresponding growth rate of 225.4 percent. For the first quarter of FY07, receipts are forecasted to fall by 20.8 percent because collections in the first quarter of FY06 contained the one-time floor stocks tax.

Property tax revenues totaled \$325.0 million in the first two quarters of FY06, representing growth of 11.4 percent from a year earlier. Receipts in property tax are sensitive to timing of payments, and in the first half of the fiscal year payments of real property taxes were received earlier than

**Table 6**  
**FY06 Interim General Fund Revenue Forecast**  
**Compared to Official Estimate**  
**(mil \$)**

	<u>Interim</u> <u>Estimate</u>	<u>Official</u> <u>Estimate</u>	<u>Dif</u>
Sales & Use	2,701.0	2,706.6	-5.6
Individual Income	2,929.4	2,925.5	3.9
Corp Inc. & Lic.	928.7	928.7	0.0
Coal Severance	207.7	214.3	-6.6
Cigarette (inc. flr stocks tax)	182.0	181.5	0.5
Property	495.7	495.7	0.0
Lottery	170.0	170.0	0.0
Other	<u>593.8</u>	<u>593.8</u>	<u>0.0</u>
<b>General Fund</b>	<b>8,208.3</b>	<b>8,216.2</b>	<b>-7.9</b>

in the previous year. It is expected that in the remaining two quarters of FY06, property tax revenues will fall 5.7 percent to \$170.7 million. Property tax collections in the first quarter of FY07 will decline 27.2 percent to \$38.9 million, due primarily to timing issues.

Lottery revenues fell 11.2 percent in the first half of FY06. The decline was a result of unexpected revenues received in the first half of FY05, when Powerball sales boosted revenues to the state. In the next two quarters, lottery revenues are expected to rise by 24.8 percent. For the first quarter of Fiscal Year 2007, lottery receipts should grow by 11.8 percent.

The “other” category contains estimates for several of the smaller revenue sources not otherwise classified. During the last two quarters of FY06 this category should experience growth of 17.0 percent. Strong growth is anticipated due to several measures: the imposition of telecommunications excise and gross receipts taxes, in-

creased enforcement revenue, and redirecting abandoned property receipts to the General Fund. Receipts in this account will continue to see strong growth in the first quarter of FY07, with receipts totaling \$138.8 million.

## ROAD FUND

Road Fund revenues are forecasted to grow by 2.9 percent over the final six months of FY06 and 0.6 percent in the first quarter of FY07 as shown on Table 7. This forecast is unchanged from the official revised consensus revenue estimates including legislation enacted by the 2005 Kentucky General Assembly.

Motor fuels tax receipts are forecasted to grow by 6.0 percent in the last two quarters of FY06. This is principally due to a change in forecasted gasoline prices and their effect on the statutory rate of the motor fuels tax. Gasoline prices have averaged higher than experienced in the preceding fiscal year; the resulting tax rate

**Table 7**  
**Road Fund: Interim Forecast**  
(millions of dollars)  
January 2006

	FY06		FY06		FY06		FY07	
	Quarters 1 & 2		Quarters 3 & 4		Full Year		First Quarter	
	Actual	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago	Interim Estimate	% Chg Year Ago
Motor Fuels	266.3	9.4	262.2	6.0	528.5	7.7	144.1	6.3
Motor Vehicle Usage	199.0	-1.4	202.2	-1.7	401.2	-1.5	108.3	-7.9
Motor Vehicle License	33.0	5.4	57.2	-5.6	90.2	-1.8	17.2	4.9
Motor Vehicle Operators	6.8	126.7	9.8	237.9	16.6	181.4	3.5	6.1
Weight Distance	42.9	3.1	42.5	2.4	85.4	2.8	21.8	0.9
Investment	1.3	-23.5	2.5	-34.2	3.8	-30.9	2.3	228.6
Other	19.7	-0.8	24.3	10.8	44.0	5.3	9.4	-1.2
<b>Road Fund</b>	<b>569.0</b>	<b>4.9</b>	<b>600.7</b>	<b>2.9</b>	<b>1,169.7</b>	<b>3.8</b>	<b>306.6</b>	<b>0.6</b>

will be higher than last year. Growth in this account will continue into FY07 with receipts in the first quarter totaling \$144.1 million.

Motor vehicle usage tax collections are expected to fall by 1.7 percent in the final two quarters of FY06. Receipts in the first two quarters fell by 1.4 percent. Growth is expected to remain weak as the popular employee discounts and other incentives are discontinued or scaled back, affecting sales of new cars. Collections in the first quarter of FY07 will fall 7.9 percent to \$108.3 million.

To estimate the growth of all other components of the Road Fund, officials of the Kentucky Transportation Cabinet and staff of the Governor's Office for Economic Analysis together assessed recent growth

patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to fall 5.6 percent in the final two quarters of FY06 but rise 4.9 percent in the first quarter of FY07. Motor vehicle operators' licenses are projected to rise by 237.9 percent in the remainder of the fiscal year due to a statutory change in drivers' license fees from \$8 to \$20. Growth in this account will slow to 6.1 percent in the first quarter of FY07. Weight distance tax revenue should improve by 2.4 percent for the remainder of the fiscal year but slow to 0.9 percent in the first quarter of FY07. Investment income should decline by 34.2 percent due to lower fund balances for the remainder of FY06 but see strong growth of 228.6 percent in the following quarter. All other revenues should combine for growth of 10.8 percent during the last six months of FY06 and fall 1.2 percent in the first quarter of FY07.

**Table 8**  
**FY06 Interim Road Fund Revenue Forecast**  
**Compared to Official Estimate**  
**(mil \$)**

	<b><u>Interim Estimate</u></b>	<b><u>Official Estimate</u></b>	<b><u>Dif</u></b>
Motor Fuels & MF Use/Surtax	528.5	528.5	0.0
Motor Vehicle Usage & Rental	401.2	401.2	0.0
Motor Vehicle License	90.2	90.2	0.0
Motor Vehicle Operators	16.6	16.6	0.0
Weight Distance Tax/Surtax	85.4	85.4	0.0
Investment	3.8	3.8	0.0
Other	44.0	44.0	0.0
<b>Road Fund</b>	<b>1,169.7</b>	<b>1,169.7</b>	<b>0.0</b>

## ECONOMIC OUTLOOK

The economic outlook presented here is for the three-quarter period from January to September 2006. In terms of fiscal years this period is the second half of FY06 (quarters 3 and 4) and the first quarter of FY07. The national outlook is based on Global Insight's November 2005 forecast, and the Kentucky outlook is from GOEA's November 2005 forecast. The economic outlook is identical to the one the Consensus Forecasting Group used in arriving at their forecast in December.

### National Economy

During FY06 all indicators associated with a broad recovery are strongly positive. Real GDP has been moving strongly for the past two years and was up 3.5 percent in the first half of FY06 compared to the same period in FY05. Other factors like investment, productivity, and consumer confidence show robust growth. And finally, even employment has shown a strong upward movement during the first two quarters of FY06.

During the second half of FY06 real GDP is expected to grow by 3.5 percent from a year ago. Growth is expected to continue along the same path, averaging 3.4 percent in the first quarter of FY07. Employment in nonfarm industries, which had shown slow growth during the recovery so far, is forecasted to post robust job gains of 1.5 percent during the remainder of the fiscal year, and in FY07:Q1.

The consumption component of GDP has been the major factor in sustaining growth. During the last two quarters of FY06 real consumption expenditures are projected to increase by 2.7 percent with durable goods

rising by just 0.2 percent. Consumption growth during the FY07:Q1 is expected to be 2.8 percent. The relatively slow growth in the consumption of durable goods is tied to the fortunes of the motor vehicles and parts industry. Real consumption of motor vehicles is forecasted to register a decline of 5.1 percent in the second half of FY06.

Investment spending has been accelerating in recent months, and the outlook is for a continuation of that trend. During the second half of FY06 investment is expected to rise by 7.2 percent, and then by 7.6 percent in the first quarter of FY07. The surge in investment is from the expectation that consumer demand will increase and the economy will continue to expand.

### State Economy

The impact of the national recovery is being felt in the state economy. However, the dominance of the goods-producing sector in the state economy has slowed the recovery. During the final two quarters of FY06 personal income is estimated to increase by 5.6 percent compared to a 6.1 percent increase nationally. The recovery is expected to be stronger during the first quarter of FY07 with income growth of 5.9 percent. This will, however, be still under the national average of 7.2 percent. The relative strength in the national income figures is primarily from the robust performance of income derived from dividends, interest, and rent.

During the first half of FY06 total nonagricultural employment in Kentucky was up 1.2 percent compared to a year ago. A combination of factors are, however, expected to push employment growth to 1.4 percent in the second half of the year, followed by similar growth in the first

quarter of FY07. These factors are related not to just a boost in consumer confidence and the subsequent increase in consumer demand, but also to increased investment and exports.

Employment in goods-producing industries had declined dramatically in Kentucky in response to productivity gains and the shift of some manufacturing facilities abroad. During the second half of FY06 employment in goods-producing industries is forecasted to be up 0.6 percent followed by a growth of 0.4 percent in the first quarter of FY07. In spite of strong growth in con-

struction and mining the slim overall growth in the goods sector is because of flat manufacturing employment.

Service-providing industries are forecasted to do well during the second half of FY06 with an addition of 18,500 jobs. The growth rate during the first quarter of FY07 is expected to be a robust 1.8 percent. The improvement in employment is related to the continuing expansion of business services and health care services which have done well in Kentucky even during the recession years.

**Table 9**  
**Economic Outlook: Second Half of FY06**

	<b>FY05</b> <b><u>Q3 &amp; Q4</u></b>	<b>FY06</b> <b><u>Q3 &amp; Q4</u></b>	<b><u>Percent</u></b> <b><u>Change</u></b>
<b>United States</b>			
Real GDP (billion 2006 \$)	11,044.3	11,433.3	3.5
Personal Income (billion \$)	10,147.3	10,770.0	6.1
Nonfarm Employment (million)	133.1	135.2	1.5
Unemployment Rate (%)	5.2	4.9	-
<b>Kentucky</b>			
Personal Income (million \$)	120,736	127,485	5.6
Wage & Salary Income (million \$)	64,350	66,896	4.0
Nonfarm Employment ('000)	1,808.7	1,833.4	1.4
Goods producing ('000)	371.7	373.8	0.6
Service Providing ('000)	1,127.7	1,146.2	1.6

**Table 10**  
**Economic Outlook: First Quarter of FY07**

	<b><u>FY06</u></b> <b><u>Q1</u></b>	<b><u>FY07</u></b> <b><u>Q1</u></b>	<b><u>Percent*</u></b> <b><u>Change</u></b>
<b>United States</b>			
Real GDP (billion 2000 \$)	11,193.2	11,568.5	3.4
Personal Income (billion \$)	10,293.0	11,029.0	7.2
Total Nonfarm Employment (million)	134.0	136.0	1.5
Unemployment Rate (percent)	5.0	4.8	-
<b>Kentucky</b>			
Personal Income (million \$)	123,336	130,603	5.9
Wage & Salary Income (million \$)	65,163	68,371	4.9
Nonfarm Employment ('000)	1,817.7	1,843.5	1.4
Goods producing ('000)	372.3	373.8	0.4
Service Providing ('000)	1,134.7	1,155.5	1.8

\*Seasonally adjusted annual rate.

Sources: Global Insight, and U.S. Department of Commerce, BEA.

Data for FY06-FY07 are November 2005 estimates.



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## **APPENDIX**

# KENTUCKY STATE GOVERNMENT REVENUE

	Second Quarter 2005 - 2006	Second Quarter 2004 - 2005	% Change	Year-To-Date 2005 - 2006	Year-To-Date 2004 - 2005	% Change
<b>TOTAL GENERAL FUND</b>	<b>\$2,188,649,584</b>	<b>\$1,962,218,917</b>	<b>11.5%</b>	<b>\$4,154,386,979</b>	<b>\$3,723,601,370</b>	<b>11.6%</b>
<b>Tax Receipts</b>	<b>\$2,100,130,056</b>	<b>\$1,861,262,978</b>	<b>12.8%</b>	<b>\$4,007,474,209</b>	<b>\$3,548,740,778</b>	<b>12.9%</b>
<b>Sales and Gross Receipts</b>	<b>\$763,922,994</b>	<b>\$678,980,630</b>	<b>12.5%</b>	<b>\$1,556,608,895</b>	<b>\$1,373,754,417</b>	<b>13.3%</b>
Beer Consumption	1,784,169	1,455,112	22.6%	3,285,810	3,289,881	-0.1%
Beer Wholesale	12,779,318	9,045,064	41.3%	23,173,740	19,574,916	18.4%
Cigarette	44,848,234	3,915,926	1045.3%	86,047,554	7,914,017	987.3%
Cigarette Floor Stock	9,855	0	---	12,120,794	0	---
Distilled Spirits Case Sales	29,064	23,103	25.8%	46,696	45,362	2.9%
Distilled Spirits Consumption	2,997,824	2,166,104	38.4%	4,971,734	4,456,738	11.6%
Distilled Spirits Wholesale	6,797,027	4,555,547	49.2%	11,360,872	8,787,233	29.3%
Insurance Premium	6,560,938	10,785,462	-39.2%	38,808,850	35,929,070	8.0%
Pari-Mutuel	1,388,231	1,384,142	0.3%	2,290,361	1,402,860	63.3%
Race Track Admission	54,103	55,418	-2.4%	182,164	154,401	18.0%
Sales and Use	682,985,306	642,791,567	6.3%	1,368,469,772	1,287,202,262	6.3%
Wine Consumption	432,515	743,260	-41.8%	823,045	1,223,942	-32.8%
Wine Wholesale	3,256,411	2,059,924	58.1%	5,027,504	3,773,734	33.2%
<b>License and Privilege</b>	<b>\$83,533,559</b>	<b>\$73,250,053</b>	<b>14.0%</b>	<b>\$163,321,439</b>	<b>\$139,643,507</b>	<b>17.0%</b>
Alc. Bev. License Suspension	52,250	41,600	25.6%	98,650	103,850	-5.0%
Coal Severance	53,119,431	44,115,301	20.4%	105,438,591	87,008,973	21.2%
Corporation License	16,204,175	18,476,265	-12.3%	31,129,972	31,967,320	-2.6%
Corporation Organization	69,010	38,001	81.6%	137,210	58,344	135.2%
Occupational Licenses	19,551	24,307	-19.6%	45,836	81,288	-43.6%
Oil Production	1,598,318	1,223,151	30.7%	3,207,383	2,241,855	43.1%
Race Track License	99,725	103,750	-3.9%	261,075	263,250	-0.8%
Bank Franchise Tax	832,445	(202,048)	---	642,823	7,241	8777.2%
Driver License Fees	135,483	129,249	4.8%	297,297	271,791	9.4%
Minerals Severance	4,488,129	3,926,332	14.3%	8,720,716	7,626,179	14.4%
Natural Gas Severance	6,915,041	5,374,145	28.7%	13,341,886	10,013,417	33.2%
	0	0				
<b>Income</b>	<b>\$960,361,555</b>	<b>\$835,353,064</b>	<b>15.0%</b>	<b>\$1,921,556,681</b>	<b>\$1,694,980,980</b>	<b>13.4%</b>
Corporation	212,722,277	96,255,629	121.0%	407,090,290	214,272,655	90.0%
Individual	747,639,278	739,097,435	1.2%	1,514,466,391	1,480,708,325	2.3%
<b>Property</b>	<b>\$271,514,936</b>	<b>\$253,029,671</b>	<b>7.3%</b>	<b>\$324,954,612</b>	<b>\$291,591,783</b>	<b>11.4%</b>
Bank Deposits	7,041	0	---	7,041	0	---
Building & Loan Association	(120,207)	0	---	48,322	71,384	-32.3%
Distilled Spirits	328,958	87,769	274.8%	403,142	87,769	359.3%
General - Intangible	23,497,902	20,294,490	15.8%	23,503,667	20,298,320	15.8%
General - Real	144,760,741	136,386,530	6.1%	145,105,396	136,609,630	6.2%
General - Tangible	68,975,272	65,085,999	6.0%	91,377,857	86,807,551	5.3%
Omitted & Delinquent	9,777,798	6,605,289	48.0%	17,815,728	11,361,580	56.8%
Public Service	24,283,537	24,564,927	-1.1%	46,689,446	36,335,053	28.5%
Other	3,896	4,667	-16.5%	4,013	20,497	-80.4%
<b>Inheritance</b>	<b>\$12,277,411</b>	<b>\$12,513,315</b>	<b>-1.9%</b>	<b>\$23,493,613</b>	<b>\$31,672,876</b>	<b>-25.8%</b>
<b>Miscellaneous</b>	<b>\$8,519,600</b>	<b>\$8,136,246</b>	<b>4.7%</b>	<b>\$17,538,969</b>	<b>\$17,097,216</b>	<b>2.6%</b>
Legal Process	5,905,772	5,947,534	-0.7%	12,722,687	12,881,674	-1.2%
T. V. A. In Lieu Payments	2,459,752	2,169,899	13.4%	4,640,898	4,196,730	10.6%
Other	154,076	18,813	719.0%	175,384	18,813	832.3%
<b>Nontax Receipts</b>	<b>\$85,366,455</b>	<b>\$99,695,567</b>	<b>-14.4%</b>	<b>\$141,877,598</b>	<b>\$172,257,253</b>	<b>-17.6%</b>
Departmental Fees	5,876,326	5,092,736	15.4%	11,412,320	11,060,044	3.2%
PSC Assessment Fee	410,898	75,361	---	8,778,161	11,108,369	-21.0%
Fines & Forfeitures	6,432,582	6,262,042	2.7%	13,040,588	12,842,763	1.5%
Interest on Investments	307,507	199,013	54.5%	542,658	440,215	23.3%
Lottery	40,000,000	41,752,000	-4.2%	77,000,000	86,752,000	-11.2%
Sale of NOx Credits	0	0	---	136,000	3,230,425	-95.8%
Miscellaneous	32,339,142	46,204,415	-30.0%	30,967,871	46,713,438	-33.7%
<b>Redeposit of State Funds</b>	<b>\$3,153,073</b>	<b>\$1,260,372</b>	<b>150.2%</b>	<b>\$5,035,172</b>	<b>\$2,603,339</b>	<b>93.4%</b>

# KENTUCKY STATE GOVERNMENT REVENUE

	Second Quarter 2005 - 2006	Second Quarter 2004 - 2005	% Change	Year-To-Date 2005 - 2006	Year-To-Date 2004 - 2005	% Change
<b>TOTAL ROAD FUND</b>	<b>\$264,302,885</b>	<b>\$256,663,036</b>	<b>3.0%</b>	<b>\$568,986,990</b>	<b>\$542,568,469</b>	<b>4.9%</b>
<b>Tax Receipts-</b>	<b>\$257,561,040</b>	<b>\$249,531,336</b>	<b>3.2%</b>	<b>\$554,360,863</b>	<b>\$527,833,716</b>	<b>5.0%</b>
<b>Sales and Gross Receipts</b>	<b>\$212,131,404</b>	<b>\$208,570,222</b>	<b>1.7%</b>	<b>\$465,323,827</b>	<b>\$445,088,069</b>	<b>4.5%</b>
Motor Fuels Taxes	125,226,309	112,616,058	11.2%	255,481,383	\$234,486,374	9.0%
Motor Fuels Use & Surtax	5,370,921	3,585,481	49.8%	10,606,339	\$8,586,467	23.5%
Truck Trip Permits (fuel)	94,840	103,415	-8.3%	187,280	\$237,580	-21.2%
Motor Vehicle Usage	81,439,335	92,265,268	-11.7%	199,048,824	\$201,777,648	-1.4%
<b>License and Privilege</b>	<b>\$45,429,635</b>	<b>\$40,961,113</b>	<b>10.9%</b>	<b>\$89,037,037</b>	<b>\$82,745,647</b>	<b>7.6%</b>
Motor Vehicles	16,616,126	14,512,307	14.5%	33,006,734	\$31,338,262	5.3%
Motor Vehicle Operators	3,514,066	1,399,627	151.1%	6,771,397	\$3,031,645	123.4%
Weight Distance	21,255,333	20,825,566	2.1%	42,883,598	\$41,612,294	3.1%
Truck Decal Fees	31,451	678,944	-95.4%	75,670	\$810,472	-90.7%
Other Special Fees	4,012,660	3,544,669	13.2%	6,299,638	\$5,952,974	5.8%
<b>Nontax Receipts</b>	<b>\$6,657,172</b>	<b>\$6,899,806</b>	<b>-3.5%</b>	<b>\$13,683,067</b>	<b>\$14,357,482</b>	<b>-4.7%</b>
Departmental Fees	3,987,017	4,114,439	-3.1%	8,221,369	\$8,580,313	-4.2%
In Lieu of Traffic Fines	282,671	325,579	-13.2%	615,951	\$694,884	-11.4%
Highway Tolls	1,583,037	1,481,524	6.9%	3,172,045	\$3,113,743	1.9%
Investment Income	611,756	824,778	-25.8%	1,335,668	\$1,724,629	-22.6%
Miscellaneous	192,691	153,486	25.5%	338,034	\$243,913	38.6%
<b>Redeposit of State Funds</b>	<b>\$84,673</b>	<b>\$231,895</b>	<b>-63.5%</b>	<b>\$943,060</b>	<b>\$377,271</b>	<b>150.0%</b>